



Australian Government

**Improvements to the calculation and
collection of income tax liabilities
from consolidated groups**

Discussion Paper

June 2010

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ISBN

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Consultation Process

Request for feedback and comments

We invite interested parties to lodge written submissions on the design of this proposal.

Submissions will be made available on the Treasury website unless you clearly indicate that you would like all or part of your submission to remain confidential. Automatically generated confidentiality statements in emails do not suffice for this purpose. A request made under the *Freedom of Information Act 1982* for access to a submission marked confidential will be determined in accordance with that Act.

Closing date for submissions: 6 August 2010

Email: consolidation@treasury.gov.au

Mail: The Manager
Company Tax Unit
The Treasury
Langton Crescent
PARKES ACT 2600

Inquiries: Tony Regan
Manager, Company Tax Unit

Phone: (02) 6263 3334

Teresa Bostle
Senior Advisor, Company Tax Unit

Phone: (02) 6263 3005

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FOREWORD

I am pleased to release this discussion paper on proposals to improve the calculation and collection of income tax liabilities from consolidated groups.

This paper on improving the operation of rules relating to the calculation and collection of income tax liabilities from consolidated groups and multiple entry consolidated groups (MEC groups) provides an opportunity for interested parties to express their opinions on the proposed changes.

Consultation plays a valuable role in the development of policy responses to changes in the tax law and I look forward to receiving the views of the community on these important reforms.

SIGNED

Assistant Treasurer
Senator Nick Sherry

1. INTRODUCTION

1. On 11 May 2010, the Assistant Treasurer, Senator the Hon Nick Sherry, announced that the Government will introduce legislation to improve the calculation and collection of income tax liabilities from consolidated groups and multiple entry consolidated groups (MEC groups). The proposed amendments will confirm existing practices by addressing minor technical deficiencies in the existing law.
2. Specifically, the Government will legislate to:
 - ensure an entity can leave a consolidated group with a clear exit from certain income tax liabilities;
 - clarify that the joint and several liability rules apply to an appropriate extent where an entity is partially exempt from those rules;
 - clarify that a provisional head company of a MEC group can enter into a tax sharing agreement with other members of the group;
 - clarify that Pay As You Go (PAYG) instalments paid by a former provisional head company of a MEC group are attributed to that MEC group;
 - ensure the joint and several liability rules apply appropriately where a mature PAYG consolidated group is acquired by a PAYG transitional group; and
 - ensure the income tax law applies to MEC groups in the same way it applies to consolidated groups.
3. The media release is available on the Assistant Treasurer's website (see Media release No. 091 of 11 May 2010).

2. PURPOSE

4. This discussion paper forms the basis for consultation on these proposals and sets out, in broad terms, the way they may be implemented. The purpose of this discussion paper is to provide interested parties with an opportunity to comment on the policy design of the proposals.
5. All references are to the *Income Tax Assessment Act 1997* (ITAA 1997), unless otherwise specified.

3. CLARIFY AN ENTITY CAN LEAVE A CONSOLIDATED GROUP OR A MEC GROUP WITH A CLEAR EXIT

6. Subsection 721-10(1) specifies that Division 721 operates if:
 - a tax-related liability (a group liability) of the head company of a consolidated group was not paid or otherwise discharged in full by the time the liability became due and payable (the head company's due time); and
 - one or more entities (contributing members) were subsidiary members of the group for at least part of the period to which the group liability relates.
7. Section 721-15 confirms that each subsidiary member of a consolidated group is jointly and severally liable in the event the head company does not pay the liability by the due date. However, the extent of a subsidiary member's joint and several liability can be limited where the group liability is the subject of a valid tax sharing agreement (section 721-25).
8. In addition, section 721-35 enables a TSA contributing member to leave a consolidated group clear of a group liability where the tax sharing agreement is valid and the leaving entity has paid their contribution amount to the head company before the leaving time.
9. The clear exit can only be obtained in respect of the liabilities contained in the current tax sharing agreement. The clear exit rules do not extend to liabilities that were dealt with in previous tax sharing agreements.

PROPOSED CHANGES

10. Amendments are proposed to clarify that a TSA contributing member can obtain a clear exit under section 721-35. This can be achieved by ensuring that the date an original assessment is due and payable is the only relevant date for a leaving entity that is a TSA contributing member to obtain a clear exit for the original assessment and any subsequent amendments.
11. Therefore, the TSA contributing member will be taken to have paid the contribution amount to the head company for the purposes paragraph 721-35(c) if:
 - item 15, 20, 22, 65 or 70 of the table in subsection 721-10(2) applies to the liability; or
 - item 25 of the table in subsection 721-10(2) applies to the liability and the liability is due and payable under subsection 204(2) of the *Income Tax Assessment Act 1936* (ITAA 1936) (that is, it relates to an amended assessment).

APPLICATION DATE

12. The outcome under the proposed amendments is consistent with the outcome prior to the amendments to subsection 204(2) of the ITAA 1936 made by the *Tax Laws Amendments (Improvements to Self Assessment) Act (No 1) 2005* and with existing practice. Therefore the amendments will apply from the 2004-05 and subsequent income years.

4. REMOVE A REDUNDANT PROVISION ABOUT THE EXTENT OF LIABILITY WHERE THE EFFECT OF AN AUSTRALIAN LAW IS TO EXEMPT THE COMPANY FROM JOINT AND SEVERAL LIABILITY

13. In some cases, an entity is exempt or partly exempt from joint and several liability under an Australian law. For example, section 38 of the *Life Insurance Act 1995* limits the joint and several liability of life insurance companies to assets that are not statutory fund assets, that is, assets that are not attributable to policyholders.
14. The effect of the governing Australian law extends to liabilities that arise under income tax law. Subsection 721-15(2) is consequently unnecessary as the law already operates to limit the extent of joint and several liability arising from an unpaid group liability.

PROPOSED CHANGES

15. For the purposes of clarifying the law, it is proposed to remove subsection 721-15(2) from the ITAA 1997.

APPLICATION DATE

16. The changes will apply from 11 May 2010 (date of announcement). In this regard, as the provision has had no effect, it is unnecessary to make this amendment retrospective.

5. CLARIFY THAT A PROVISIONAL HEAD COMPANY OF A MEC GROUP CAN ENTER INTO A TAX SHARING AGREEMENT WITH OTHER MEMBERS OF THE GROUP

17. Where a head company does not pay a liability by the date due and payable, Division 721 confirms that the subsidiary members of the group are jointly and severally liable, unless the ITAA 1997 modifies that approach. The existence of a tax sharing agreement that is recognised under Division 721 is the main mechanism for modifying the application of the joint and several liability rules.
18. Where a tax sharing agreement is recognised by the ITAA 1997, limits on the amount of liability that will be collected from the individual subsidiary members apply. In that case, the Commissioner seeks to recover only the specified reasonable portion from each member, in accordance with the tax sharing agreement.

PROPOSED CHANGES

19. It is proposed to amend Division 721 to clarify that, when the head company or provisional head company of a MEC group enters into a tax sharing agreement that is recognised under Division 721 with other members of the group, the tax sharing agreement effectively modifies the approach to joint and several liability (in the same way that an effective tax sharing agreement modifies the approach to joint and several liability for consolidated groups).
20. In addition, there may be a change of the provisional head company of a MEC group during an income year because:
 - the former provisional head company exits the group; or
 - the former provisional head company ceases to be eligible to be the provisional head company of the MEC group and, as a result, becomes a subsidiary member of the group.
21. In these cases, for the purpose of applying section 721-35 to any tax sharing agreement entered into by the former provisional head company in respect of the income year:
 - the former provisional head company will be taken to be a subsidiary member of the group in respect of a group liability covered by the tax sharing agreement; and
 - the new provisional head company will be treated as if it entered into the agreement, in the capacity as the provisional head company.

APPLICATION DATE

22. The amendments will apply from 11 May 2010 (date of announcement).

6. CLARIFY THAT PAYG INSTALMENTS PAID BY A FORMER PROVISIONAL HEAD COMPANY OF A MEC GROUP ARE ATTRIBUTED TO THAT GROUP

23. The single entity rule applies for the purpose of applying the PAYG instalment provisions in Part 2-10 of Schedule 1 to the *Taxation Administration Act 1953* (Taxation Administration Act) (section 45-710 of Schedule 1 to the Taxation Administration Act).
24. The table in subsection 45-910(2) modifies Part 2-10 so that the provisions have effect in relation to MEC groups. Specifically:
 - a reference to a consolidated group is taken to be a reference to a MEC group;
 - a reference to the head company of a consolidated group is taken to be a reference to the provisional head company of a MEC group; and
 - a reference to a subsidiary member of a consolidated group is taken to be a reference to a member (other than the provisional head company) of the MEC group.

25. Subdivision 45-S of Schedule 1 to the Taxation Administration Act explains how Part 2-10 applies to MEC groups.
26. Under section 45-30, a taxpayer is entitled to a credit for PAYG instalment payments made in respect of an income year when an income tax assessment is made for the taxpayer.
27. Section 161 requires the head company of the consolidated group or MEC group to lodge the income tax return for the preceding income year. Section 166 requires the Commissioner to make an assessment income and tax payable of any taxpayer, in this case the head company of the consolidated group or MEC group.

PROPOSED CHANGES

28. Amendments are proposed so that, where there is a change to the head company of a consolidated group (or the provisional head company of a MEC group) during an income year, credits arising from PAYG instalment payments made by the former head company (or the former provisional head company) in respect of the income year are credited to the group.
29. To achieve this, section 45-30 of Schedule 1 to the Taxation Administration Act will be amended where:
 - there is a change of the head company of a consolidated group or of the provisional head company of a MEC group, during an income year; and
 - an amount of instalment payable by the former head company or the former provisional head company, or amount of credit claimed by it under sections 45-215 or 45-250, are taken into account in working out a credit entitlement of the new head company or new provisional head company.
30. In these circumstances, to the extent that the amount is taken into account by the new head company, it will not be taken into account in working out any credit entitlement of the former head company or the former provisional head company under section 45-30 for any year. The new head company may only take into account credit entitlements of the former head company or the former provisional head company that arose in its capacity as the head company or former provisional head company.
31. In addition, item 2 in the table in subsection 45-910(2) will be amended to reflect that a reference to the head company of a consolidated group is taken to be a reference to the head company or provisional head company of a MEC group.
32. Further, where there is a change in the head company of a consolidated group before the former head company lodges the income tax return or pays the income tax liability for an income year, the new head company will be required to lodge the income tax return for that income year and will be liable for any consequent income tax liability arising from that return. This will ensure that the new head company can perform its tax obligations.

33. Similarly, where a new provisional head company of a MEC group is appointed before the former head company (or provisional head company) lodges the income tax return or pays the income tax liability for an income year, the new provisional head company will be required to lodge the income tax return and will be liable for the consequent income tax liability arising from that return. This will ensure that the new provisional head company can perform its income tax obligations.

APPLICATION DATE

34. The amendments confirm existing practice and therefore will apply from 1 July 2002.

7. ENSURE THE JOINT AND SEVERAL LIABILITY RULES APPLY WHERE A MATURE PAYG CONSOLIDATED GROUP IS ACQUIRED BY A PAYG TRANSITIONAL GROUP

35. Subdivision 45-R of Schedule 1 to the Taxation Administration Act contains special rules that apply to members of a consolidated group after the group has come into existence but before the members are treated as a single entity for PAYG purposes (a PAYG transitional group). One of these special rules is that the single entity rule is disregarded for the purposes of determining the PAYG instalment, so that each subsidiary member must pay their own tax-related liability during the consolidation transitional year (section 45-855). The head company is not liable for the debts of the subsidiary members during this transitional year.
36. The single entity rule starts to apply for the purposes of determining the PAYG instalments the head company must pay during the income year from, broadly, the start of the instalment quarter during which the Commissioner gives the head company an initial head company instalment rate (section 45-705).

PROPOSED CHANGES

37. The proposed amendments will clarify that, if a member of a consolidated group is treated as if it were the head company of another group for PAYG purposes because of section 45-880 of Schedule 1 to the Taxation Administration Act, that entity is treated as the head company of a consolidated group for the purposes of Division 721 of the ITAA 1997 in respect of any tax-related liability of that other group.
38. This will ensure that the joint and several liability rules apply to all members of the acquired mature PAYG group when it is acquired by a transitional PAYG group.

APPLICATION DATE

39. The amendments will apply from 11 May 2010 (date of announcement).

8. ENSURE THE JOINT AND SEVERAL LIABILITY RULES APPLY TO THE GENERAL INTEREST CHARGE

40. Subdivision 45-P of Schedule 1 to the Taxation Administration Act contains the anti-avoidance rules relating to PAYG instalments. The Subdivision applies, broadly, if a taxpayer gets a tax benefit from a scheme (section 45-600). If Subdivision 45-P applies to a scheme, the taxpayer is liable to pay the general interest charge on twice the amount of the tax benefit (section 45-620).
41. If the taxpayer is a consolidated group or MEC group, the head company (or provisional head company) is liable to pay the general interest charge arising under section 45-620. However, as that liability is not listed as a tax-related liability in the table in subsection 721-10(2) of the ITAA 1997, Division 721 of that Act does not apply to liability.
42. In addition, the liability to pay the general interest charge that arises under section 45-620 is not listed as a tax-related liability in the table in subsection 250-10(2) of Schedule 1 to the Taxation Administration Act although this is nonetheless recoverable as a tax-related liability.

PROPOSED CHANGES

43. To overcome these concerns:
 - the table of tax-related liabilities in subsection 721-10(2) of the ITAA 1997 will be amended to include a reference to the general interest charge payable under subsections 45-620(2) and (4) of Schedule 1 to the Taxation Administration Act; and
 - the table of tax-related liabilities in subsection 250-10(2) of Schedule 1 to the Taxation Administration Act will be amended to include a reference to the general interest charge payable under subsections 45-620(2) and (4).

APPLICATION DATE

44. The amendments will apply from 11 May 2010 (date of announcement).

9. CLARIFY THAT VARIOUS PARTS OF THE INCOME TAX LAW WHICH APPLY TO CONSOLIDATED GROUPS ALSO APPLY TO MEC GROUPS

45. There are a number of provisions in the income tax law that specifically apply to consolidated groups for the purposes of calculating and collecting the group's income tax-related liabilities. In some cases, the provisions do not expressly refer to MEC groups, or to the head company or provisional head company of a MEC group, causing confusion as to their application to MEC groups.

46. The amendments will clarify that these provisions apply to MEC groups for the purposes of calculating and collecting their income tax-related liabilities in the same way that they apply to consolidated groups.

PROPOSED CHANGES

Income Tax Assessment Act 1936

47. It is proposed to amend the *Income Tax Assessment Act 1936* to:
- insert a definition of MEC group into subsection 6(1);
 - insert a definition of provisional head company into subsection 6(1);
 - ensure that the table in subsection 171A(1) applies to MEC groups; and
 - ensure that section 177EB applies to MEC groups.

Income Tax Assessment Act 1997

48. It is proposed to amend the *Income Tax Assessment Act 1997* to:
- ensure that section 110-35 applies to MEC groups;
 - ensure that section 112-97 applies to MEC groups;
 - ensure that subsection 118-425(12) applies to MEC groups;
 - ensure that subsection 118-427(12) applies to MEC groups;
 - modify section 719-2 so that the modification applies to income tax law (as defined) instead of Part 3-90;
 - modify section 719-60 to clarify that the provisional head company of a MEC group is taken for the purpose of applying the income tax law as being the head company of the MEC group at all times during the income year, until the head company is identified at the end of the group's income year – that is, the provisional head company is taken to be the head company until such time the actual head company can be determined; and
 - modify section 719-75 to clarify that the provisional head company is taken for the purposes of applying the income tax law as being the head company of the MEC group at all times during the income year, until the head company is identified at the end of the group's income year – that is, the provisional head company is taken to be the head company until such time the actual head company can be determined and can enter into transaction, agreements, etc as if it is the head company at that time.

Income Tax (Transitional Provisions) Act 1997

49. It is proposed to amend the *Income Tax (Transitional Provisions) Act 1997* to ensure that paragraph 126-150(1)(d) applies to MEC groups.

APPLICATION DATE

50. The amendments confirm existing practice and therefore will apply from 1 July 2002.